

Persons who permanently affix tangible personal property to real estate, thereby making improvements to real estate, are considered to be construction contractors. In Illinois, construction contractors are deemed to be the users of the items that they permanently affix to realty and owe Use Tax on the cost price of the tangible personal property that they so affix to real estate. See 86 Ill. Adm. Code 130.2075. (This is a GIL).

May 17, 1999

Dear Xxxxx :

This letter is in response to your letter dated April 17, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

I would appreciate your opinion regarding the use tax ramifications in the State of Illinois of the following scenario.

A company with its corporate office located in Illinois manufactures tools used in the construction industry at an out of state facility. The tools are shipped to a business location in Illinois where they are leased to an affiliated company which then leases the tools to construction companies for use in their business.

My understanding of Illinois sales and use tax law is that the user is responsible for use tax on the purchase price of the tangible personal property incorporated into the finished product and that the use tax would be imposed at the time the tools are shipped into Illinois. My question concerns the out of state location where the tools are manufactured. Will manufacture of the tools at an out of state location have any impact on the tax base that the use tax is applied to? From an accounting standpoint, there are three components to the finished cost of the construction tools. Raw materials, labor and allocated overhead. Will the use tax be applied to only the cost of the raw materials or should it also include the cost of labor and/or overhead?

I would appreciate any assistance that you can provide me regarding this issue.

Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2 (1996 State Bar Edition). The Use Tax Act imposes a tax on purchasers by taxing the use of tangible personal property purchased from retailers. 35 ILCS 105/3 (1996 State Bar Edition).

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Please note that if contractors make "over-the-counter" sales of items that are not permanently attached to real estate, they act as retailers. Such sales are subject to the Retailers' Occupation Tax based upon their selling price. If contractors buy parts that they will sell "over-the-counter," they may purchase such parts tax-free by providing suppliers with Certificates of Resale. See 86 Ill. Adm. Code 130.1405, enclosed, which describes the requirements for Certificates of Resale.

In Illinois, lessors of tangible personal property under a true lease, except for automobiles leased for terms of one year or less, are considered to be the end users of the property to be leased. See the enclosed copies of 86 Ill. Adm. Code 130.220 and 130.2010. As the end users of tangible personal property located in Illinois, lessors incur Use Tax on the lessors' cost price of the property. Since lessors are considered the end users of the property and have paid the Use Tax, no Retailers' Occupation Tax is imposed upon the rental receipts and the lessees incur no Use Tax liability for the rental charges. In Illinois, a true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease.

The alternative to a true lease is a conditional sale. In Illinois, a conditional sale is usually characterized by a nominal purchase option at the close of the lease term. This type of transaction is considered a conditional sale at the outset of the transaction making all receipts subject to Retailers' Occupation Tax. See Section 130.2010. In this situation, lessors/retailers may give Certificates of Resale to their suppliers for tangible personal property transferred subject to a conditional sales agreement. The lessors/retailers owe Retailers' Occupation Tax on any installment payments when they are received by the lessors/retailers. The lessees/purchasers owe corresponding Use Tax on the amount of the installment payments that are collected by the lessors/retailers.

As stated above, lessees do not incur any tax liability in a true lease situation. However, it is typical of true leases to contain contractual provisions stating that the lessees will *reimburse* the lessors for their tax costs. This is not a matter of Illinois tax law but of private agreement between lessors and lessees. If the lessees agreed to such provisions, they are bound to

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satisfy that duty because of a contractual agreement, not because of Illinois tax law.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Gina Roccaforte
Associate Counsel

GR:msk

Enc.